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In the Supreme Court of the United States

OCTOBER TERM, 1974

SECURITIES INVESTOR PROTECTION CORPORATION,
PETITIONER

v.

JAMES C. BARBOUR, AS RECEIVER FOR GUARANTY BOND AND SECURITIES CORPORATION AND GUARANTY BOND COMPANY, INC., AND SECURITIES AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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OPINIONS BELOW

The opinion of the court of appeals (App. 80)[1] is reported at 496 F. 2d 145. The opinion of the district court (App. 72) is unreported.

JURISDICTION

The judgment of the court of appeals (App. 90) was entered on April 23, 1974. The petition for a writ of certiorari was filed on July 20, 1974, and was

[1] "App." refers to the joint appendix filed in this case.

granted on October 21, 1974 (App. 92). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

The Commission will discuss only the first question on which certiorari was granted (see note 2, *infra*):

1. Whether customers of a member have an implied private right of action to compel the Securities Investor Protection Corporation ("SIPC") to meet its alleged obligation to them under the Securities Investor Protection Act of 1970 ("SIPA" or "the Act"), despite Section 7(b) thereof which grants that right only to the Securities and Exchange Commission.

STATUTES INVOLVED

Section 7(b) of the Securities Investor Protection Act of 1970, 84 Stat. 1653, 15 U.S.C. 78ggg(b), provides:

> In the event of the refusal of SIPC to commit its funds or otherwise to act for the protection of customers of any member of SIPC, the Commission may apply to the district court of the United States in which the principal office of SIPC is located for an order requiring SIPC to discharge its obligations under this chapter and for such other relief as the court may deem appropriate to carry out the purposes of this chapter.

Other provisions of the Act, 5 U.S.C. 78eee, *et seq.*, are set forth in the Appendix to Petitioner's brief.

STATEMENT

The Securities Investor Protection Corporation is a non-profit membership corporation whose members include all persons registered as brokers or dealers

under the Securities Exchange Act of 1934 (Section 3(a) of the Securities Investor Protection Act of 1970, 15 U.S.C. 78ccc(a)). It was created by the Securities Investor Protection Act of 1970 to provide greater protection to the customers of members. S. Rep. No. 1218, 91st Cong., 2d Sess., pp. 1–4; H. Rep. No. 1613, 91st Cong., 2d Sess., p. 1–4. Under the Act, SIPC may apply to a court for a decree initiating liquidation proceedings if it determines that a member has failed or is in danger of failing to meet its obligatons to its customers and that one or more specified conditions indicating financial difficulty exist (15 U.S.C. 78eee(a)(2) and (b)(1)). If the application is granted, SIPC is obligated, if necessary, to advance moneys to meet certain customer claims from a fund established and maintained by required contributions from its members (15 U.S.C. 78 fff(f)). Should the fund become insufficient for the purposes of the Act, the Securities and Exchange Commission is authorized to make loans to SIPC and to borrow from and issue notes for this purpose to the Secretary of the Treasury in an aggregate amount not to exceed $1,000,000,000 (15 U.S.C. 78ddd(g) and (h)).

The Securities and Exchange Commission is also given certain supervisory authority over SIPC, and it is specifically authorized to apply to a district court for an order requiring SIPC to discharge its obligations under the Act (15 U.S.C. 78ggg).

From June 20, 1962, until after the effiective date of the Securities Investor Protection Act on December 30, 1970, Guaranty Bond and Securities Corporation ("Guaranty Bond") was a broker-dealer registered with the Securities and Exchange Commission

pursuant to Section 15(b) of the Securities Exchange Act of 1934, 48 Stat. 895, as amended, 15 U.S.C. 78*o* (b) (App., p. 2). On December 22, 1970, the Commission filed a complaint and moved for a preliminary injunction against Guaranty Bond, alleging, *inter alia*, that Guaranty Bond was and had been in violation of the Commission's "net capital rule" (17 C.F.R. 240.15c3–1) (App., p. 1).

On January 6, 1971, the district court found that Guaranty Bond had been in violation of the net capital rule for a substantial period of time prior to the filing of the complaint and issued a preliminary injunction against further violations (App., pp. 41–53). On January 29, 1971, on the Commission's motion, the court appointed a receiver for Guaranty Bond (App., pp. 54–59).

On March 31, 1972, after the receiver had substantially completed the liquidation of Guaranty Bond, he filed a petition with the district court in the Commission's injunction action asking that SIPC and the Commission be ordered to show cause why SIPC should not be required to intervene in the action and extend the protection of the Act to the customers of the brokerage firm (App., pp. 19–27). The district court issued the requested order and subsequently filed a Memorandum Opinion (App., pp. 72–78) in which it held: (1) The receiver could maintain an action against SIPC on behalf of the customers of Guaranty Bond (App., pp. 75–76), but (2) the customers of the firm were not entitled to protection under the Act because the evidence demonstrated that the firm was "hopelessly insolvent" prior to the effective date of the Act, and "to grant the requested

relief would be a retroactive application of the Act and a clear frustration of legislative intent" (App., pp. 76–78).

The court of appeals agreed with the district court that the receiver had standing to bring an action seeking the customer protections provided under the Act (App., pp. 88–89). It reversed the determination that Guaranty Bond's customers were not entitled to protection under the Act, however, because of the substantial business Guaranty Bond had conducted after the effective date of the Act (App., pp. 86–87)—a fact that was disputed below.

ARGUMENT

THE STATUTORY AUTHORITY OF THE SECURITIES AND EXCHANGE COMMISSION TO INSTITUTE AN ACTION TO COMPEL THE SECURITIES INVESTOR PROTECTION CORPORATION TO DISCHARGE ITS OBLIGATIONS UNDER THE SECURITIES INVESTOR PROTECTION ACT IS THE EXCLUSIVE MEANS BY WHICH THAT CORPORATION CAN BE COMPELLED TO TAKE ACTION

The primary question presented in this case is whether there is an implied private right of action under the Securities Investor Protection Act in addition to the right of action expressly granted to the Commission under Section 7(b) of the Act. We submit that the right of action granted to the Commission is the exclusive means by which the Securities Investor Protection Corporation (SIPC) can be compelled to take action.[2]

[2] If our submission is accepted, this Court need not reach the second question on which certiorari was granted—whether a receiver of a member has standing to maintain suit. If, however, contrary to our submission, this Court holds that a pri-

1. The Securities Investor Protection Act is designed to provide financial relief for customers who incur losses as a result of financial difficulties of broker-dealer members of SIPC. S. Rep. No. 1218, *supra,* at p. 4; H. Rep. No. 1613, *supra,* at pp. 3–4. To this end, the Act establishes procedures for the orderly liquidation of a financially troubled member under the supervision of SIPC. The provisions of the Act involved here neither create standards of conduct nor impose liability on members.[3] The Act is thus unlike other federal securities laws which prohibit activities harmful to investors.

Where federal securities laws establish standards of conduct designed to protect investors, the Commission has urged, and this Court and lower courts have recognized, that violations give rise to implied causes of action by injured investors.[4]

vate cause of action should be implied, the question of the receiver's standing would also have to be resolved. Although the status of a receiver and that of customers of a member may differ for purposes of standing, this brief is confined to a discussion of the first question presented since, in our view, the fundamental error of the decision below is its implication of a private cause of action without regard to who may have standing to assert it.

[3] Another important purpose of the Act is to increase the financial responsibility of broker dealers by enlarging the Commission's power to establish financial responsibility rules (15 U.S.C. 78ggg(a)), and by requiring self-regulatory organizations to adopt procedures for financial examination of members (15 U.S.C. 78iii(f)). These provisions are not involved in this case, and there is no occasion to consider whether private rights of action may be implied to enforce the duties created by the Commission's rules issued under these provisions.

[4] See, *e.g., J. I. Case Co.* v. *Borak*, 377 U.S. 426, 431–435; *Superintendent of Insurance of New York* v. *Bankers Life &*

For example, in *J. I. Case Co.* v. *Borak,* 377 U.S. 426, this Court recognized an implied private right of action to redress violations of Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78n, relating to proxy solicitation, stating (377 U.S. at 432):

> Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in antitrust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements. The Commission advises that it examines over 2,000 proxy statements annually and each of them must necessarily be expedited. Time does not permit an independent examination of the facts set out in the proxy material and this results in the Commission's acceptance of the representations contained therein at their face value, unless contrary to other material on file with it. Indeed, on the allegations of respondent's complaint, the proxy material failed to disclose alleged unlawful market manipulation of the stock of ATC, and this unlawful manipulation would not have been apparent to the Commission until after the merger.

Casualty Co., et al., 404 U.S. 6; *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128; *Baird* v. *Franklin*, 141 F. 2d 238 (C.A. 2), certiorari denied, 323 U.S. 737; *Slavin* v. *Germantown Fire Ins. Co.*, 174 F. 2d 799 (C.A. 3); *Hooper* v. *Mountain States Securities Corp., et al.*, 282 F. 2d 195 (C.A. 5), certiorari denied, 365 U.S. 814; *Greater Iowa Corporation* v. *McLendon*, 378 F. 2d 783 (C.A. 8); *Fratt* v. *Robinson*, 203 F. 2d 627 (C.A. 9); *Crist* v. *United Underwriters, Ltd.*, 343 F. 2d 902 (C.A. 10).

In the case of a statute regulating conduct, a private cause of action serves to encourage compliance with the statutory standard and to bring violations to the attention of officials having enforcement responsibility. Cf. *Allen* v. *State Board of Elections*, 393 U.S. 544, 556. Neither purpose would be aided in the case of the Securities Investor Protection Act.

As indicated earlier (p. 6, *supra*), the provisions of the Act involved here do not impose standards of conduct on members. In light of the extensive reporting and inspection procedures established by federal securities laws, a private right of action is unnecessary to apprise SIPC or the Commission of the financial difficulties of a broker-dealer. Member firms must keep detailed records (Rule 17a–3, 17 C.F.R. 240.17a–3) and file certified annual reports with the Commission (Rule 17a–5, 17 C.F.R. 240.17a–5). Moreover, immediate telephonic notice and current reports must be furnished to the Commission whenever net capital falls below the minimum required (Rule 17a–11, 17 C.F.R. 240.17a–11). In addition, the Commission maintains an active inspection program,[5] as do the self-regulatory organizations in the securities industry (15 U.S.C. 78iii(c)), which must report any financial difficulties uncovered to the Commission as well as SIPC (15 U.S.C. 78eee(a)(1)).

2. As shown above, the factors which traditionally have justified the implication of a private right of action are not present in this case. The decision below is, moreover, subject to a more fundamental objec-

[5] See 39th Annual Report of the Securities and Exchange Commission (1973), pp. 58–59.

tion—the implication of a private right of action may frustrate the purposes of the Act.

Congress intended that SIPC perform and the Commission exercise its supervisory authority, consistent with the public interest (15 U.S.C. 78kkk(a); 15 U.S.C. 78ccc(e)(3); 15 U.S.C. 78fff(d)). While the protection of customers of SIPC members is the primary goal of the Act, Congress accorded SIPC and the Commission discretion to achieve that goal in the manner most consistent with the public interest.

Accordingly, the most important responsibility of SIPC is to determine whether to apply to a district court for a decree initiating liquidation proceedings with respect to a member.[6] The Act provides that SIPC "may" apply for such a decree if it determines that certain conditions exist (15 U.S.C. 78eee(a)(2)). If SIPC refuses to make such application, the Commission "may" apply to the district court in which SIPC's principal office is located for an order requiring SIPC to act (15 U.S.C. 78ggg(b)). Implicit in this permissive language is the recognition that in some cases, the public interest may be better served if liquidation proceedings are deferred and thus perhaps avoided altogether, even though a basis for initiating such proceedings may exist.

Forbearance may allow time for other viable solutions, such as the infusion of new capital, the transfer of accounts to a financially healthy firm, or the merger, acquisition or self-liquidation of the troubled firm. Whether liquidation proceedings should be in-

[6] If SIPC's application is granted, it is obligated, if necessary, to advance moneys to meet certain customer claims. See p. 3, *supra*.

stituted may depend on sophisticated financial analyses and familiarity with the investment banking industry, both of which are within the area of the Commission's expertise because of its regulation of broker-dealers under the Securities Exchange Act of 1934.

The decision of the court below may impair the ability of both SIPC and the Commission to exercise properly the discretion to determine the need for liquidation proceedings.

A broker-dealer's customer or its representative would rarely consider the public interest in determining whether to bring an action to compel proceedings under the Act. As SIPC points out (Pet., p. 15), such an action might be brought with respect to a firm in weak but not terminal financial condition and as the result of legitimately disputed transactions between the firm and the customer; such an action, because of the attendant unfavorable publicity, could start a fatal run on the firm. Moreover, by bringing an action prematurely a customer might destroy viable alternatives to liquidation proceedings.[7]

[7] While these considerations are not applicable to this case since receivership proceedings were nearing completion when SIPC was requested to act, they are relevant to the future administration of the Act. Indeed, the present case was one of the first cases to arise under the Act, and questions concerning the retroactive application of the Act will not recur. Moreover, the factual posture of this case is not likely to recur because both the Commission and the self-regulatory organizations now automatically advise SIPC whenever their inspection and reporting programs reveal that a brokerage firm is approaching financial difficulty. The Commission also gives SIPC specific data concerning a firm whenever the Commission is considering the institution of an action based on the firm's failure to meet its financial responsibilities.

3. We submit that the decision below is contrary to the principles of *Nat'l R. R. Passenger Corp.* v. *Nat'l Ass'n of R. R. Passengers,* 414 U.S. 453, where this Court refused to infer a general private cause of action under the Rail Passenger Service Act of 1970 because, *inter alia,* a private action might impair effective operation of the statute. Cf. *Massachusetts Universalist Convention* v. *Hildreth & Rogers Co.,* 183 F. 2d 497, 500–501 (C.A. 1).

Like Section 307 of the Rail Passenger Service Act of 1970, 84 Stat. 1333, 45 U.S. 547, which authorized only suits by the Attorney General to compel compliance with the Act, Section 7 of the Securities Investor Protection Act authorizes only the Commission to proceed against SIPC. Nothing in either the legislative history [8] or other provisions of the Act [9] suggests that Congress intended to permit private suits.

[8] The House Report (H. Rep. No. 1613, 91st Cong., 2d Sess., p. 22.) stated:

"Section 7(b) of the bill provides that, should SIPC refuse to commit its funds or otherwise act for the protection of customers of any member, the Commission could apply to a court for an order requiring SIPC to discharge its obligations under this legislation or for such other relief as the court may deem appropriate to carry out the purposes of the legislation—for example, requiring SIPC to file an application * * * [for a decree initiating a liquidation proceeding]."

[9] The court of appeals erroneously relied (App., p. 88) on Section 3(b)(1) of the Act, 15 U.S.C. 78ccc(b)(1), which empowers SIPC "to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any court, State, or Federal" as support for implication of a private right of action. This provision does not create cause of action; it merely permits SIPC to be sued *eo nomine.* See *Blackmar* v. *Guerre,*

The Court also referred to the fact that the statute there involved provided for scrutiny "by both Congress and the Executive * * *." 414 U.S. at 464. Comparably, Section 7(c)(2) of SIPA, 15 U.S.C. 78ggg (c)(2), provides that "[a]s soon as practicable after the close of each fiscal year, SIPC shall submit to the Commission a written report relative to the conduct of its business, and the exercise of the other rights and powers granted by * * *" the Act and that "[t]he Commission shall transmit such report to the President and the Congress with such comment thereon as the Commission may deem appropriate." Indeed, the Commission would appear to have more detailed supervisory power under SIPA than does the Attorney General under the Rail Passenger Service Act. See, *e.g.*, 15 U.S.C. 78ccc(e) (2) and (3); 15 U.S.C. 78ggg(c)(1).

Because of the Commission's responsibilities to regulate broker-dealers under the Securities Exchange Act of 1934 and to supervise SIPC under the Securities Investor Protection Act,[10] the Commission, and

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342 U.S. 512. Indeed, the same power was conferred on the National Railroad Passenger Corporation by the provision subjecting it to the District of Columbia Business Corporation Act (45 U.S.C. 541). See *Keifer & Keifer* v. *Reconstruction Finance Corporation*, 306 U.S. 381, 390.

[10] The House Report (H. Rep. No. 1613, 91st Cong., 2d Sess., p. 12.) stated:

"Your committee has, however, provided for substantial oversight on the part of the Commission over the conduct of the affairs of SIPC. * * *"

* * * * *

"Your committee, not only directs, but expects the Commission to use its oversight in a vigorous, but fair, manner. Only with cooperation and coordination between the efforts of

not customers or a receiver of a broker-dealer, should determine whether SIPC has acted improperly in not instituting liquidation proceedings.[11]

CONCLUSION

For the foregoing reasons, we submit that the court of appeals erred in holding that there is an implied private right of action to compel SIPC to file an application to commence liquidation proceedings under the Act; accordingly, the judgment should be reversed.

Respectfully submitted.

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the self-regulatory organizations, SIPC and the Commission, can this legislation see its fullest effectiveness."

[11] We do not maintain that Congress intended that the protections of the Act might be arbitrarily withheld from customers of an insolvent broker-dealer whose claims cannot otherwise be satisfied. See S. Rep. No. 1218, 91st Cong., 2d Sess., p. 3; H. Rep. No. 1613, 91st Cong., 2d Sess., p. 3. It may be, therefore, that a determination by the Commission not to take action under Section 7(b) would be judicially reviewable for abuse of discretion. See *Nat'l R. R. Passenger Corp.* v. *Nat'l Ass'n of Railroad Passengers*, *supra*, 414 U.S. at 465 (concurring opinion of Mr. Justice Brennan).

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